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Nos. 76-568 and 76-632

In the Supreme Court of the United States

OCTOBER TERM, 1976

WHITE & CASE and MARION JAY EPLEY, III,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

LORD, BISSELL & BROOK, MAX E. MEYER
and LOUIS F. SCHAUER, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (W&C Pet. 1a-7a [1]) is reported at 538 F. 2d 404. The opinion and order of the district court (App. 136-151, 164-165) are not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on May 17, 1976. A suggestion for rehearing *en banc* was denied on August 11, 1976 (W&C Pet. 8a-9a). The petition for a writ of certiorari in No. 76-568 was filed on October 22, 1976, and in No. 76-632 on November 4, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Following a formal investigation by the Securities and Exchange Commission of alleged violations of the federal securities laws, in which attorneys who had participated in the transactions involved were questioned after receiving *Miranda*-type warnings, the Commission instituted an action to enjoin, among others, those attorneys from violating the securities laws. The question presented is whether the Com-

[1] The petition filed by petitioners White & Case and Epley is cited as "W&C Pet. ———." The petition filed by Lord, Bissell & Brook, Meyer, and Schauer is cited as "LBB Pet. ——." Pages in the joint appendix filed by the parties in the court of appeals, a copy of which is being lodged with the Clerk of this Court, are cited as "App. ——."

mission was precluded from bringing the action because it had not first given the lawyers the opportunity to present to the Commission or its staff arguments why they should not be included as defendants in the injunctive action.

CONSTITUTIONAL PROVISION INVOLVED

The Fifth Amendment to the United States Constitution, and the Commission Memorandum, dated September 1, 1970, are set forth at W&C Pet. Apps. C and D.

STATEMENT

In February 1972 the Securities and Exchange Commission filed in the United States District Court for the District of Columbia an action for an injunction charging that 20 defendants, including petitioners and National Student Marketing Corporation ("NSMC"), which had approximately 2,400 stockholders (App. 53), had violated the anti-fraud provisions,[2] the proxy provisions[3] and the reporting provisions of the federal securities laws[4] (App. 51-

[2] Section 17(a) of the Securities Act of 1933, 48 Stat. 74, 84-85, as amended 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 881, 891, 15 U.S.C. 78j(b) and Commission Rule 10b-5 promulgated thereunder, 17 CFR 240.10b-5.

[3] Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(a), and rules promulgated thereunder.

[4] Section 13(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78m(a), and rules promulgated thereunder.

58). The complaint alleged a scheme by which NSMC and its officers and directors, with the active assistance and participation of petitioners, perpetrated a major fraud upon the investing public and the securities markets (App. 51-103). The filing of the complaint followed a formal Commission investigation (discussed below), in which several of the petitioners testified.

1. According to the complaint, an important part of the fraudulent scheme, in which petitioners participated, involved NSMC's acquisition by merger of Interstate National Corporation ("Interstate"), a publicly-held corporation with approximately 1,200 stockholders (App. 87-93). At the closing of this transaction on October 31, 1969, all of the petitioners were informed that NSMC's financial statements for the nine months ended May 31, 1969, did not correctly reflect the results of its operations (App. 87-90). Those statements showed a $700,000 profit for this period, which had been reported to the shareholders of both companies in proxy-soliciting material used to obtain their approval of the merger (App. 87-88). In fact, the statements should have reflected a loss in that period (*ibid.*).

NSMC's correct financial situation was disclosed in a so-called "comfort letter" issued by accountants for NSMC and transmitted to petitioner Epley, a partner in petitioner White & Case, NSMC's legal counsel at the merger closing (App. 87-90). The complaint alleged that, despite their knowledge of

the statements contained in the "comfort letter," petitioners White & Case and Epley gave the requisite legal opinions at the closing, which stated, among other things, that all steps in connection with the merger had been validly taken and were not in violation of any laws (App. 90). The closing took place even though the participants, including petitioners, knew that the financial statements upon which the merger was based and upon which the stockholders had approved the merger were false, and without resolicitation of the shareholders (App. 87-93).

The stock of NSMC was also being traded on the basis of the false financial statements. The market value of the NSMC stock the Interstate shareholders received in the merger in exchange for their Interstate stock was approximately $37 million (App. 88, 94).

The complaint further alleged that a number of the principal officials and stockholders of Interstate, including petitioner Max E. Meyer, upon the advice of petitioner Lord, Bissell & Brook and with the knowledge of petitioner White & Case, sold on the day of the closing approximately $3 million of NSMC stock that they had received as a result of the merger (App. 93). These shares were sold to unsuspecting public investors, notwithstanding that petitioners knew, as a result of the comfort letter, that the most current financial information available to the public concerning NSMC was materially false and misleading (App. 93-94). Thereafter, NSMC

and its officers and directors, with the active participation of petitioners White & Case and Epley, continued to conceal the facts set forth in the comfort letter by failing to disclose them in periodic reports filed by NSMC with the Commission, even though public investors were trading NSMC stock in the open market on the basis of financial statements known by petitioners to be false (App. 87-93).

2. The Commission's formal investigation that led to the filing of its complaint was based on information reported by its staff raising questions about (1) the adequacy of disclosures contained in a September 1969 proxy statement in connection with the NSMC-Interstate merger, in a registration statement of NSMC filed in October 1969, and in NSMC's 1968 and 1969 annual reports filed with the Commission and (2) possible violations of the antifraud provisions of the securities laws by NSMC, its officers and directors, or "affiliated persons" (App. 4-7). Members of the Commission's staff, in meetings with representatives of NSMC, including petitioner Epley and another attorney from petitioner White & Case, had requested information relating to the apparent discrepancy between NSMC's reported income for 1969 and the company's prior financial statements (App. 29-39). These persons were told that transactions and practices in which they had personally participated were under Commission scrutiny (App. 30, 32-33, 38).

The Commission gave the same information to the individual petitioners when they testified at the formal agency investigation. Each was shown the order of investigation, which stated that the investigation was being conducted to determine, *inter alia*, whether violations of the federal securities laws had been committed by NSMC, its officers and directors, or any "affiliated persons."

Each witness, when called to testify under oath, was explicitly told that he had a right to be accompanied and represented by counsel of his own choosing,[5] and each of the individual petitioners was represented by an attorney during his testimony. Petitioners Epley and Schauer were also informed at the outset of their testimony that they need not answer any question that might tend to incriminate them or subject them to fine, penalty or forfeiture; petitioner Meyer was present when petitioner Schauer was so informed (App. 191-192, 196-200). At the close of the testimony of each of the individual petitioners, the staff member conducting the examination advised each witness that he could make a statement on the record about any matter relating to the investigation (App. 194, 197-198, 201-203).

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[5] The staff sought to assure that witnesses understood their right to be represented by an attorney of their own choosing. For example, when petitioner Epley appeared to testify, accompanied by Mr. Paul Bschorr, a White & Case attorney, the staff member conducting the examination asked whether Mr. Epley was aware that Mr. Bschorr had represented several other witnesses in the investigation and whether, in light of that fact, Mr. Epley was prepared to proceed with Mr. Bschorr as his counsel (App. 191).

3. Petitioners' Fifteenth Defense in their answer to the Commission's complaint[6] was (App. 105):

> The Securities and Exchange Commission violated its own rules, procedures, and directives and the United States Constitution by instituting this action without informing * * * [petitioners] that they were prospective defendants or targets of the Commission investigation prior to the institution of the suit, and without affording * * * [petitioners], or their counsel, an opportunity to present their contentions to the Commission or the Commission staff as to why they should not be sued.

This defense relied upon an internal nonpublic memorandum from the Commission to its senior staff dated September 1, 1970. That memorandum provides certain procedures "that the staff should adopt" (W&C Pet. 11a) in administrative proceedings and injunctive actions (W&C Pet. 11a-13a), and in the concluding paragraph "requests" that in both categories

> the staff's memoranda to the Commission recommending the particular action set forth separately any arguments or contentions as to either the facts or the law involved in the case which have been advanced by the prospective respondents and which countervail those made by the staff in its memoranda as a basis for the recommendation. [W&C Pet. 13a.]

[6] The defense was so designated in the answer of petitioners White & Case and Epley (App. 105). A similar defense was contained in an amended answer of petitioners Lord, Bissell & Brook, Meyer, and Schauer, and the term "Fifteenth Defense" is here used to include the defense in that answer as well.

Petitioners contended that the memorandum—which the Commission neither formally promulgated nor published[7]—required the staff to notify them prior to the institution of the action in order to give them an opportunity to persuade the Commission not to bring it.

The district court struck the Fifteenth Defense as "insufficient as a matter of law" (App. 148). On interlocutory appeal, the court of appeals affirmed, ruling that there was "no procedural infirmity, Constitutional or statutory * * *" (W&C Pet. 5a).[8]

ARGUMENT

The issue petitioners raise need not be resolved at this preliminary stage of the litigation. In any event,

[7] The only public reference to the internal procedures set forth in the memorandum was contained in a report issued several months after the institution of this action by an advisory committee formed by the Commission in January 1972 to study and make recommendations to improve the Commission's enforcement policies and practices. See *Report of the Advisory Committee on Enforcement Policies and Practices* (the "Wells Committee"), pp. 31-33 (June 1, 1972), BNA Sec. Reg. & L. Rep. No. 158 Extra Edition (June 28, 1972), and Securities Exchange Act Release No. 9486 (January 28, 1972). (See n.11, pp. 12-13, *infra*.)

[8] Judge McGowan dissented because he was not prepared to say that the "defense in issue should have been stricken by the district court without more exploration on the record of both the authority and the justifications for the staff's proceeding as it did in this case" (W&C Pet. 7a).

the decision of the court of appeals is correct and does not conflict with any decision of this Court or of another court of appeals.

1. At the present stage of this case, all that has happened is that petitioners' Fifteenth Defense has been eliminated. The district court merely has rejected the claim that the Commission was barred from bringing this suit against the petitioners because it had not first given them the opportunity to argue to the agency that they should not have been named as defendants against whom injunctive relief should be granted. There has been no determination of either the merits of the Commission's substantive claims or its entitlement to relief against petitioners. As the district court stated (App. 120), "Legal rights and liabilities have not yet been determined."[9]

Although petitioners contend (W&C Pet. 13; LBB Pet. 6) that the mere institution of this action has damaged their reputations, by their own theory any such damage has already been done. It could not be undone by dismissing the suit without an adjudication on the merits. Petitioners will have a full opportunity to vindicate their conduct on any trial of the case and on any appeal from an adverse decision. If an injunction ultimately is issued against petitioners

[9] This statement appeared in a memorandum opinion (App. 113-121) accompanying the court's original order striking the Fifteenth Defense. Subsequently the court withdrew that order to permit a record to be developed concerning the purpose of the Commission's September 1, 1970, memorandum (App. 122-123). Thereafter it entered the order here under review, again striking the Fifteenth Defense (App. 151).

and the court of appeals sustains it, petitioners could challenge the district court's striking of their Fifteenth Defense in a petition for certiorari filed at that time. See, *e.g.*, *Rexford* v. *Brunswick-Balke Co.*, 228 U.S. 339, 346. There is no occasion for this Court to review at this stage the preliminary technical issue which petitioners raise.

2. Petitioners' contention (W&C Pet. 15) that "[t]he decision below cannot be reconciled with controlling authority in this Court or the decisions of other Circuits" is incorrect. The cases on which petitioners rely (W&C Pet. 15-18) involve publicly-disseminated regulations designed to safeguard the rights of participants in agency proceedings. By contrast, the Commission's memorandum to its staff involved in this case was circulated solely within the agency, not publicly. It is an internal housekeeping document, which, on its face, merely requests, but does not require, that the staff advise the Commission, in recommending particular action, of different viewpoints that have been expressed by proposed respondents. An administrative agency's failure to comply with nonpublic procedures contained in internal guidelines or instructional manuals issued for use by agency staff personnel does not ordinarily justify dismissal of an agency proceeding.[10] *Ameri-*

[10] Contrary to petitioners' contention (W&C Pet. 20-22) the district court did not decide the scope and meaning of the 1970 memorandum on the basis of an *in camera* review of "secret materials." It determined, on the basis of an *in camera* review, that the 67 documents requested by petitioners were governmental memoranda containing advice or

can Farm Lines v. *Black Ball Freight Service*, 397 U.S. 532, 539; *United States* v. *Lockyer*, 448 F.2d 417 (C.A. 10); *United States* v. *Leahey*, 434 F.2d 7, 11 (C.A. 1).

When the Commission has sought to require its staff to follow certain procedures with respect to investigations, it has done so expressly, in clear and unmistakable terms, and published the rules in the Federal Register.[11] As the court of appeals pointed

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opinions and that none was either legally or factually relevant to determining the scope and meaning of the 1970 memorandum (App. 140-145). See, *e.g.*, *Renegotiation Board* v. *Grumman Aircraft Engineering Corp.*, 421 U.S. 168, and *National Labor Relations Board* v. *Sears, Roebuck & Co.*, 421 U.S. 132. The court was fully entitled to resolve issues of privilege, *e.g.*, intra-agency advice and opinions, and relevance through an *in camera* inspection. *United States* v. *Nixon*, 418 U.S. 683, 714-715.

[11] By contrast, internal procedures set forth in the 1970 memorandum were publicly discussed only in the report of the Wells Committee. See n.7, p. 9, *supra*. That committee expressly recognized that, under the practice embodied in the 1970 memorandum, submissions on behalf of prospective defendants were received "only if the attorney takes the initiative in requesting that his client's views be submitted to the Commission." Wells Committee Report, p. 31. Following the Wells Committee Report, the Commission issued Release No. 5310 (September 27, 1972), in which it expressly rejected the Wells Committee recommendation that the Commission adopt rules for pre-proceeding notification of prospective defendants. In that release, it also announced to the public that the "procedures which are now generally in effect" are the ones which provide that persons who become involved in a Commission investigation may "*on their own initiative*" submit a written statement to the Commission setting forth their position in regard to the matters under investigation and that the staff "*in its discretion*" may advise such persons, *inter alia*, of the general nature of the investigation, including the indicated violations, and the amount of time available for submitting a statement prior to a staff recommendation to the Commission for institution of proceedings.

out (W&C Pet. App. 6a): "Had the Commission intended to establish a procedural rule which, if breached, would require dismissal of a complaint, we think it would have said so in language far clearer and more direct than that found in the 1970 Memorandum."

Even assuming that the memorandum could be viewed as imposing general requirements, this case does not involve the type of prejudice, such as restriction of a participant's rights during an adjudicatory process (*Service* v. *Dulles*, 354 U.S. 363) or the use of statements, given without prescribed warnings, in a criminal proceeding (*United States* v. *Heffner*, 420 F.2d 809 (C.A. 4)), that warrants dismissal of the proceeding. Petitioners claim only that their reputations may have been harmed by institution of this suit. That is not sufficient reason to impose on the Commission staff an inflexible requirement that, during its investigation of possible violations of the securities laws, it discuss charges with all defendants in all civil injunctive actions. As the court of appeals noted (W&C Pet. App. 6a): "Mandating * * * a [pre-proceeding notification and solicitation of arguments] procedure would seriously burden the Commission's enforcement procedure, already characterized by adequate due process safeguards."

3. To the extent that petitioners contend that lack of notice and opportunity to be heard prior to being named defendants in a civil injunctive suit denies them due process, the claim is insubstantial.

The due process clause protects only against deprivations of "life, liberty, or property." Not every perceived disadvantage suffered by individuals as a result of government action constitutes such a deprivation. Although petitioners allege (W&C Pet. 13) that the Commission's action has resulted in "severe injury to professional standing and reputation," the Commission has simply instituted a lawsuit—a step which itself has not circumscribed any legally cognizable rights or interests, prevented petitioners from practicing their professions, or imposed any duty or liability on them. The burdens and expenses arising from litigation are part of the "social burden of living under government" and do not constitute legally recognizable injuries or deprivation of rights protected by the Constitution. *Allen* v. *Grand Central Aircraft Co.*, 347 U.S. 535, 540; *Petroleum Exploration, Inc.* v. *Public Service Commission*, 304 U.S. 209, 222; *Renegotiation Board* v. *Bannercraft Clothing Co., Inc.*, 415 U.S. 1, 24.

Furthermore, due process "does not require a trial-type hearing in every conceivable case of government impairment of private interest." *Cafeteria Workers* v. *McElroy*, 367 U.S. 886, 894-895; *Stanley* v. *Illinois*, 405 U.S. 645, 650. Notice and the opportunity to be heard are rights normally associated with adjudicatory proceedings, not fact-finding investigations in

which no determination affecting a person's rights or liabilities is made, despite the possibility that reputations might be damaged by the mere institution of suit. See *Hannah* v. *Larche*, 363 U.S. 420, 441-444; *Jenkins* v. *McKeithen*, 395 U.S. 411, 425-428. In *Hannah*, the Court specifically noted that the Securities and Exchange Commission provided notice of charges only to parties to adjudicatory proceedings, not subjects of investigation, and remarked (363 U.S. at 448):

> Undoubtedly, the reason for this distinction is to prevent the sterilization of investigations by burdening them with trial-like procedures.

Petitioners also contend that the Commission's failure to issue a "warning against lawyers who were representing clients in the course of an investigation by the agency," deprived them of "fundamental fairness" (W&C Pet. 12, 18).[12] Petitioners do not allege, however, that they would have given different answers or refrained from testifying at all if they had been given additional warnings.[13]

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[12] Although petitioners at several points imply that they were improperly questioned about NSMC affairs when they were regarded as possible defendants, they make no specific claim that this procedure denied them their constitutional rights. Indeed, as discussed in the text, petitioners were afforded the right to counsel, told that they could decline to answer questions on Fifth Amendment grounds, and given an opportunity to make a statement at the end of the questioning. Because trial has not yet begun, any suggestion that their testimony could be improperly used would be premature.

[13] Petitioners Lord, Bissell & Brook, Meyer and Schauer have suggested (LBB Pet. 5-6) that, had the Commission

CONCLUSION

For the foregoing reasons, the petitions for a writ of certiorari should be denied.

Respectfully submitted.

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given them the benefit of pre-proceeding notification and an opportunity to present their views about why they should not be sued, "there is a substantial likelihood that LBB would not have been named in this [civil] proceeding" just as it was not named a defendant in criminal actions that have been brought arising out of NSMC's improper accounting. See *United States* v. *Randell*, S.D.N.Y., 74 Cr. 43; *United States* v. *Davies*, S.D.N.Y., 74 Cr. 985; *United States* v. *Natelli*, 527 F.2d 311 (C.A. 2), certiorari denied, 425 U.S. 934. But a determination not to prosecute may have little bearing on whether a civil suit should be instituted. Indeed, sometimes the bringing of a criminal action will make a civil action unnecessary, while on other occasions the lack of a criminal action will make a civil proceeding appropriate. Even in this case, the district court, in denying LBB's motion to dismiss and for summary judgment, stated that "[t]he acts with which the movants are charged, if performed with an awareness that previously received information concerning NSMC's earnings was false and misleading, could reasonably have been knowing and willful violations of the securities laws." *Securities and Exchange Commission* v. *National Student Marketing Corp.*, 360 F. Supp. 284, 297-298 (D.D.C.).

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